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Capital Shortage: Fact and Fancy

THE EDITORS

The Arabs in Israel

NOAM CHOMSKY

Tanzam Freedom Railroad

MARTIN BAILEY

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NOTES FROM THE EDITORS

Both editors were away from the New York area from late February to mid-March. Harry Magdoff was a visiting professor at the American University in Cairo for three weeks, and Paul Sweezy was what is called a Regents Lecturer at the Davis campus of the University of California for ten days and paid briefer visits to Berkeley, Stanford, and California State University at Chico. Trips like these serve a very useful purpose in enabling us to make new contacts and to explore what students and teachers here and abroad are thinking and doing. But they also have their drawbacks, especially in causing us to fall even further behind than usual in reading manuscripts, answering correspondence, and discharging other responsibilities connected with the magazine and the press. We are sometimes amused, especially outside the country, to find that it seems to be a rather common assumption that MR is like one of the big magazines in having a staff of secretaries and researchers (sometimes even cars and drivers) to keep everything up to date, running smoothly, etc. For better or worse (and, overall, we think it's probably for the better), the picture bears no relation to reality. There are three of us on the magazine staff, with some (much appreciated) help from those whose main responsibility

(*Continued on inside back cover*)

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CAPITAL SHORTAGE: FACT AND FANCY

One of the great ironies of our time is that precisely when all signs point to an overproduction of capital, a great hue and cry is being raised over an alleged shortage of capital. At least 25 percent of manufacturing capacity is standing idle (in some industries unused capacity is over 35 percent), residential construction is down 50 percent from its previous (1972) high, and there are far more unemployed than would be needed to operate the idle plants and machinery and to build new homes. Yet in the midst of the most severe economic decline since the Great Depression the business community and bourgeois economists are zeroing in on capital insufficiency as the most crucial problem facing U.S. capitalism. Here are some of the outcroppings of this new ideological departure.

(1) In the fall of 1974 the New York Stock Exchange issued, to the accompaniment of considerable fanfare, a scholarly-type report purporting to demonstrate that "a capital shortage is no longer a threat for the future, but a fact of the present." The Exchange statisticians calculated that while $4.7 trillion of capital will probably be needed during the coming decade, the expected supply of funds for investment from savings of business firms and individuals would amount to only $4.05 trillion, leaving an estimated capital gap of $650 billion.

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(2) The research department of the Chase Manhattan Bank, using somewhat different estimates, arrived at substantially the same disturbing conclusion. The study provided the meat for repeated full-page advertisements in the *Wall Street Journal.* Under a scare headline crying "Wolf!", Chase Manhattan warned: "We've got to build considerably more in the next ten years than we've got standing right now."

(3) ITT fell in line with the mounting clamor by proclaiming in a *Wall Street Journal* advertisement: "What happens to Capitalism if we run out of Capital? In boardrooms and treasurers' offices across the U.S. that's Topic A today."

(4) Academic and private research organization economists were not far behind in exploring the anxieties in the house of capitalism.* They warmed up their computers, gazed into crystal balls, and issued ponderous reports, concluding that the problem might not be as dire as the business community predicted. Their statistical projections showed that enough capital would probably be generated in the next ten years to meet energy needs, overcome purported shortages in raw materials processing industries, install pollution abatement equipment, as well as cope with housing and mass transportation requirements. But to achieve these goals an increased percentage of the nation's output would have to be devoted to capital investment. Thus even though the learned economists look down their noses at the alarums of the business world, they reach substantially the same conclusion: there must be a leap forward in spending for capital goods.

(5) The U.S. Department of Commerce prepared a detailed study of capital requirements, this one being limited to the remainder of the decade. The Commerce study, as reported in the 1976 *Annual Report to Congress* of the President's Council of Economic Advisers, wound up with a conclusion that was qualitatively consistent with the results of studies

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* For example: Barry Bosworth, James S. Duesenberry, and Andrew S. Carron, *Capital Needs in the Seventies* (Washington, D.C.: The Brookings Institution, 1975); and Allen Sinai and Roger Brinner, *The "Capital Shortage": Near-Term Outlook and Long-Term Prospects* (a "Special Study" incorporated in the Summer 1975 Forecast distributed to clients of Data Resources, Inc.)

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attained by business and private economists. The ratio of business fixed investment to gross national product, the study states, "may have to average 12 percent from 1975 to 1980 to meet the capital requirements projected for 1980"—a significant increase from the 10.4 percent level of the preceding decade.

(6) *Business Week* devoted a special section of its September 22, 1975, issue to what it termed "The Capital Crisis," along with a subhead about the "$4 trillion America needs to grow." Candid as usual with its business readers, *Business Week* succinctly pointed out what this hullabaloo is all about: if a larger share of the national output is to be used for capital investment, then a smaller share will be available for consumption. Closing the presumed gap betwten the supply and demand for capital, it was explained, "at a minimum requires changes in the tax structure that would provide greater incentives for savings and investment and greater disincentives for consumption."

Before we get into a more substantial evaluation of this fuss and fury over a supposed capital inadequacy, the underlying weakness of the various projections of capital supply and demand should be noted. Above all, the very attempt to make long-term estimates of needs and resources flies in the face of the inherently anarchic nature of the capitalist economy. Decisions about investment and production are made by separate individuals and corporations in the midst of constantly changing and unpredictable market conditions at home and abroad. Of necessity, forecasting can only be a guessing game in which economists and statisticians play with numbers and juggle assumptions not only about innumerable economic developments and trends but also about future policies of governments, domestic and foreign. Since changes in the short run are sometimes relatively small, the margin of forecasting error for, say, three to six months can now and then be fairly minor—although professional forecasters have as yet hardly established a trustworthy track record for even such limited projections. Detailed estimates for all areas of the economy over a decade in the future, on the other hand, can only be considered speculation pure and simple.

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Since the total unreliability of long-range economic forecasts has been demonstrated time and again and is by now obvious to everyone with eyes to see, we have to ask what real purpose they serve. And the only possible answer is that they represent a desperate effort to conceal, or perhaps in some cases wish away, infirmities in the business and banking systems —infirmities, be it noted, which the forecasting fraternity signally failed to foresee. For what we are dealing with is not what *Business Week* calls a "capital crisis," but rather a crisis of capitalism.

In examining the issues at stake we need to keep clearly in mind the distinction between *physical* and *money* capital. It is hardly surprising that money capital should be tight during some phases of the business cycle, and especially in a period when inflation is the order of the day, public and private debt are rapidly growing, and speculation is rampant. But a money-capital stringency is a very different matter from an inadequacy of real capital, or capital goods. An outstanding feature of the U.S. economy has long been an ability rapidly to expand its productive capacity. Through mastery of the machine-building processes, this country's industry has the essential ingredients for flexible self-expansion. Above all it possesses an enormous capacity to enlarge the stock of basic machine tools and other factory equipment that can be used to make still more capital goods which in turn can be applied to the mass production of consumer goods, public utility and transportation facilities, and construction materials.

Ample evidence of this phenomenal ability to make capital goods in a hurry piled up during the relatively few years of U.S. participation in the Second World War. This can best be appreciated against the background of the preceding Great Depression. Let us therefore look at some of the highlights of the decline and weak recovery of the 1930s (Table 1, p. 5).

For our present purpose we want to call attention to the listless recovery of investment. The 1920s witnessed an overproduction of capital goods relative to the effective domestic and foreign demand. Resulting cutbacks between 1929 and 1933 were drastic indeed, amounting, as can be seen in Table

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Table 1
Consumption and Investment
1929 = 100

	Personal Consumption Expenditures for Goods	*Investment in Plant and Equipment*	*Investment in Housing*
1929	100.0	100.0	100.0
1933	78.2	28.7	20.2
1939	111.8	57.7	78.8

Source: *The National Income and Product Accounts of the United States, 1929-65* (Washington, D.C.: U.S. Department of Commerce, 1966), p. 4. The data are part of the gross national product accounts, adjusted for changes in prices, and converted to relatives with 1929 as a base.

1, to more than 70 percent in plant and equipment and 80 percent in home-building. Quite a few of the machine-tool builders—the producers of machines used to make other machines and manufacturing equipment—all but closed their doors for months at a time during the depressed thirties. In industry after industry, depreciated capital stock was not replaced during most of the decade. The consequence was that even during the recovery period, from 1933 on, capital spending lagged far behind consumer purchases. By 1939 consumer demand, bolstered by various New Deal measures, stood at 12 percent above the previous prosperity peak. (This was only partly a rise in per capita consumption, since there had meanwhile been an increase of population of slightly over 7 percent.) Yet, despite the growth of consumption demand, investment had still increased to less than 60 percent of the 1929 level in the case of plant and equipment and less than 80 percent in home-building.

In these circumstances one might well have expected the tocsin to be sounded about capital shortages. After all, wasn't more capital needed to put to work the more than 17 percent of the labor force still unemployed, bring up to snuff the deteriorating and aging capital stock, and provide sorely needed housing? But clearly at that time there was no shortage of capital *from the capitalists' point of view*. Quite the contrary. Interest rates were at or near an all-time low: in 1939 the rate on three-month treasury bills was .023 percent and on top-rated corporate bonds 3.01 percent. Any credit-worthy borrower

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could easily have raised almost unlimited amounts of capital—provided, of course, there were profitable projects to spend it on. What stood in the way, therefore, was not a capital shortage but a lack of profitable investment opportunities. So the economy stagnated throughout a whole decade, with unemployment averaging more than 18 percent, idle capacity more than a third of total capacity, and the country's physical means of production aging and declining in efficiency.

In spite of this dismal record, however, it was soon to become crystal clear that the U.S. economy retained a fantastic capability for rapid self-expansion. The turnabout in real capital supply came with the outbreak of the Second World War. France and England ordered large quantities of machinery to build up their munitions-producing capacity. The United States, in turn, started an energetic program to build its own war potential, and began, under the Lend-Lease program, to produce and ship war equipment for its future allies. All this renewed business activity generated an upsurge in jobs and wages, and produced a strong advance in consumer demand.

Now, look at what happened in two strategic areas, the machinery and transportation-equipment industries (Table 2, p. 7). The sick machinery industry came back to life in only one year—advancing more than 30 percent in 1940 to surpass its previous peak in 1929.* But this sort of leap forward was only a first step in startling growth. From the record high point reached in 1940, machinery output pushed ahead by 62 percent in 1941, and continued to advance at a rate of 54 and 30 percent respectively in the first two full years of U.S. participation in the war. In three years, 1941-1943, U.S. manufacturers of these capital goods reached a level of output more than three times that of the previous high.

An even more dramatic picture presents itself in the transportation-equipment industry, which includes autos, trucks, airplanes, ships, tanks, and railroad equipment. Here we find

* There is no contradiction in the fact that 1939 machinery output as shown in Table 2 was relatively higher than the same year's investment in plant and equipment as presented in Table 1. The latter was especially depressed because of a particularly low level of new plant construction.

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Table 2
Production of Machinery and Transportation Equipment
1929 = 100

	Machinery	*Transportation Equipment*
1929	100	100
1939	80	108
1940	105	183
1941	170	346
1942	262	549
1943	341	537

Source: Board of Governors of the Federal Reserve System, *Revision of Industrial Production Index,* October 1943. The Federal Reserve Board computed these production indexes on a 1935-39 basis. These have been converted for this table to a 1929 basis.

that even though by 1939 the industry had already exceeded the former 1929 peak, production went up almost 70 percent in 1940, and by 1942 was more than five times that of 1929.

Such a miraculous production record involved of course a great deal of government intervention: guaranteeing handsome profits to corporations, shutting down for the duration of the war such activities as auto production and home-building for civilians, and establishing priorities for the use of scarce materials and components. Still, it should also be remembered that a good deal of the fantastic output of both of these major industries entailed designing and tooling up for new and challenging products. The machinery industry had to produce, among other things, an abundance of equipment that could handle the forming, shaping, and cutting of large-size and thick steel plates for tanks and warships, as well as the vast amount of specialized work needed for making the aluminum bodies and the engines for airplanes. The various transportation-equipment enterprises had to learn almost overnight to mass-produce merchant and war ships, tanks, airplanes, and heavy artillery carriers.

We chose to highlight these two industries because they are major centers of actual and potential capital goods manufactures. The heights they reached naturally called for coordinated increases in the output of many other products, as, for example, raw materials and electric power. It is important

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to understand that the astounding rates of increase shown here and those that also occurred in accompanying industries are not statistical idiosyncrasies, such as one might get by measuring recovery rates of increase from depression lows. The accelerated growth discussed here is relative to previous peaks of achievement. This could only have been realized by increasing the utilization of existing capacity, notably by adding shifts, and by a furious rate of building entirely new capacity. All this, remember, was carried out starting with plant and equipment that had been gathering rust and dust during the many years of depression and stagnation.

The history of war production thus demonstrates with crystal clarity that, as far as *real* capital is concerned, talk about a capital shortage is sheer nonsense. Not only does the United States economy have the latent ability to generate an enormous amount of new capacity, but it can fabricate a great deal more with just the existing capacity.* If the standards for getting more production used during the Second World War were applied today, we would probably find that only 50 percent, or maybe less, of existing manufacturing capacity is being used—instead of the official 75-percent figure based on current operating practices.

Matters stand entirely differently if we move from issues of *real* capital (and social needs) to the world of capitalist finance. Only then can the possibility of capital shortage be taken seriously. Here of course we become involved with the limitations of the capitalist economy, and more specifically with barriers to capitalist development that arise from the stagnation tendencies inherent in monopoly capital. The effort to maintain the flow of profits in a period of unfolding of stagnation has inevitably

* In this connection it is pertinent to point out that the potential increase today is relatively much greater than it was to the outbreak of the Second World War. In the earlier period, as we have stressed, capital stock had been allowed to age and degenerate. In the last three decades, by contrast, the capital stock has grown more or less steadily and its average age has declined. It has been estimated by John C. Musgrave (*Survey of Current Business*, March 1974) that the average age of the gross stock of manufacturing plant and equipment went down from 13.4 years in 1939 to 9 years in 1973, a decline of over 30 percent.

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led to greater and greater reliance on inflation, speculation, and debt expansion. And these in turn throw up major obstacles to further capitalist growth because they increasingly threaten the financial stability and viability of capitalist enterprise. And it is this structural weakness, not social concern about pollution of the environment or meeting the needs of the people, that provokes the furor over capital shortage. A *Wall Street Journal* article pinpoints the problem with respect to banking, as seen by money-market experts:

> At the heart of the potential trouble, these specialists say, is the inadequate capital structure supporting the banking network. That structure has been stretched thin through years of boom demand for loans; during that time, banks have been balancing burgeoning assets on an only modestly expanding capital base. Specialists in the banking industry believe that this imbalance perhaps has been pushed about as far as it can go. And with the failure of several large banks in recent years, banks and their regulators have become increasingly worried that any further erosion of capital positions could seriously undermine investor and depositor confidence in the banking industry. (June 13, 1975)

And the Council of Economic Advisers, though expressing itself in gingerly fashion, as befits a policy-making government agency, is quite frank in presenting its view of the causes of the business difficulties by highlighting the dangers associated with inflation and debt:

> The increase in debt-equity ratios during recent years has made business more vulnerable to the vicissitudes of the credit market and to unanticipated changes in the rates of inflation and profits. The tax treatment of interest payments as a deductible business expense makes debt financing particularly attractive when inflation premiums are included in interest rates. Nonetheless, debt-equity ratios have probably reached higher levels than firms would like to maintain under present conditions. While unanticipated increases in the rate of inflation have lowered the real cost of amortizing old debt, this gain has not been reflected in a higher valuation of corporate equities in periods of rising inflation. The resulting unfavorable structure of business liabilities may have created some structural financing problems, and it may have increased default risks, the costs of financing, and the cutoff rate of return on new projects. (*Economic Report of the President,* Washington, D.C., Government Printing Office, January 1976, p. 40)

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A few facts will demonstrate that structural strains have indeed, and not "may have" as the Council of Economic Advisers puts it, emerged. Look first at Table 3, which shows how nonfinancial corporations have been getting the funds they need, other than from profits generated internally.

Table 3
Sources of External Financing
Nonfinancial Corporations

	(1) *Sale of Stock*	*(2)* *Long-term Debt*[a]	*(3)* *Short-term Debt*[b]	*(4)* *Total External Financing*
		(Percentages)		
1950-54	22.7	55.7	21.6	100
1955-59	18.0	55.5	26.5	100
1960-64	7.6	63.2	29.2	100
1965-69	4.7	53.3	42.0	100
1970-74	13.9	50.1	36.0	100

(a) Bonds and mortgages.

(b) Bank loans, commercial paper, acceptances, finance company loans, and U.S. government loans.

Source: Calculated from Flow of Funds Accounts given in *Federal Reserve Bulletin,* various issues.

Two things are especially noteworthy here: (1) the relatively small proportion of new financing that comes from the sale of stocks, and the concomitant reliance on debt instruments; (2) the large and growing share of short-term debt in the total. According to the best advice found in economics textbooks and to the platitudes of the business community, the soundest and most trustworthy source of external financing should be the stock market. Profit, so the experts say, is the reward for risk-taking, and it is the willingness of capitalists to invest in risky enterprises that supplies the motive power for economic growth. Conversely, corporations will be on a firmer basis to the extent that they rely on equity capital, which does not have to be repaid, instead of on borrowing. Yet the picture for the last 25 years is at sharp variance with the conventional wisdom. At a minimum, during 1950-1954, corporations got roughly 77 percent of their outside money capital by

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going into debt, while during the years 1965-1969 they obtained about 95 percent of their external funds in this way. Even when some stabs were made at going back to the stock market for capital, as in the boom stock-market years of the early 1970s, the sale of equity securities accounted for only 14 percent of outside capital.

While corporate executives have been unwilling or unable to resort to the stock market as a source of outside funds, the bond market has developed special attractions for them. Interest payments are tax deductible. Hence as long as the debt burden does not become too heavy, the sale of bonds usually means more after-tax profits for the stockholders. Further, with seemingly unending inflation, debts can be paid off at a future date with cheaper dollars.

But debt becomes addictive. At a time of continuing inflation, with the economy slowing down and effective demand tapering off, further debt expansion becomes increasingly important, e.g., to finance the growth of consumer instalment buying and to keep the fires of speculation burning in the stock, commodities, and real-estate markets. And as difficulties arise from carrying a mounting debt load, businesses turn to still more borrowing to help repay their old debts and to meet interest charges.*

It is this growing dependence on debt that also explains in large measure the greater use of short-term borrowing to finance business operations. Concerned about the disproportionate ratio of debt to equity capital and faced with a secular rise in interest rates, businesses have turned more and more to short-term borrowing. This, they hoped, would tide them over. Business would keep on booming, profits would continue strong, so why get locked into high-interest, long-term bonds and mortgages? But reliance on short-term borrowing didn't work either, as can be seen from the data in Tables 3 and 4 (pages 10 and 12 respectively).

Table 3 depicts one aspect of the accelerating growth of

* On the importance of debt expansion in recent years, see: "The Long-Run Decline in Liquidity" (September 1970), "Keynesian Chickens Come Home to Roost" (April 1974), and "Banks: Skating on Thin Ice" (February 1975), all Reviews of the Month in MONTHLY REVIEW.

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Table 4
Outstanding Short-term Debt
Nonfinancial Corporations

	(1)	(2)	(3)	(4)	(5)
	Total Outstanding Short-term Debt[a]	*Annual Gross Corporate Product*	*Internal Funds Generated Each Year*[b]	*Outstanding Short-term Debt as a Percent of Gross Corporate Product*	*Internal Funds*
	Billions of $				
1950	20.4	151.7	22.4	13.4	91.1
1955	29.3	216.3	29.9	13.5	98.0
1960	45.3	273.1	33.3	16.6	136.0
1965	71.2	374.6	55.2	19.0	129.0
1970	128.9	516.1	63.7	25.0	202.4
1974	220.9	731.1	107.0	30.2	206.4

(a) Includes the same items as given in Note (b) to Table 3.

(b) Undistributed after-tax profits (adjusted for changes in the value of inventories) and depreciation allowances.

Source: Outstanding short-term debt—same as Table 3. Gross corporate product and internal funds—*Survey of Current Business*, various issues. The internal-funds data are called "Cash flow, net of dividends" in the gross national product accounts published in the *Survey of Current Business*.

short-term debt in the financing of corporate business. Short-term debt is always an important contributor to corporate finance. The typical practice is to borrow for short periods to cover the time interval between the purchase and processing of raw materials and the sale of the final products. Materials suppliers and wages have to be paid long before the income from the sale of finished goods is realized. Bank loans are commonly used to finance the fluctuating needs for such working capital, with loans expanding in the upward phase of the cycle and declining in the downward phase. This pattern holds for the period since the Second World War, except that something new is added in the 1960s. Up until then repayment of bank loans (and other forms of short-term credit) in recession years was either equal to or greater than new loans, so that the *net* short-term loans to corporations were negative in 1948, 1949, 1953, and 1954, and zero in 1958. Thus the fact that

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short-term loans represent 21.6 percent of external financing in 1950-1954 and 26.5 percent in 1955-1959, as can be seen in Table 3, is the result of averaging good and bad years: fairly high percentages in prosperous times offset by either negative or zero net loans in declining periods.

With the 1960s a new financial fashion shows up. Increasingly, short-term borrowing becomes a much greater proportion of external financing than in the preceding years, and no longer are there any years when net loans are brought down to zero or below. And that is why the percentages shown in the fourth column of Table 3 rise to heights far above those for the 1950s. (The decline in the *percentage* of short-term debt from 1965-1969 to 1970-1974 does not reflect any cessation in the vigorous expansion of short-term debt. It merely means that in the latter period the increase in money obtained from the stock market was greater than the rise in long- and short-term debt, due to a spurt in the flotation of stock issues in 1971 and 1972.)

The upshot of the greater reliance on short-term debt and the relevance of this development to the financial health of corporations can be examined in Table 4. The growth in outstanding short-term debt was somewhat restrained in the late 1940s and the 1950s because, as was pointed out above, there were years when net new debt was either zero or negative. But with this no longer being the case in the 1960s and thus far in the 1970s, the total amount of outstanding short-term debt has exploded.

The nub of the problem is that debts have to be repaid, and short-term debts can be called in the short run. Now as long as corporations borrowed from banks and other money-market sources to meet normal needs for working capital, prospective repayments did not need to create anxiety. However, as can be inferred from the fourth column of Table 4, short-term borrowing began to be used for much more than tiding firms over during the processing and selling stages. The short-term debt as a percent of gross corporate product skyrocketed from the 13 to 14 percent typical of the 1950s to over 30 percent in 1974. This no doubt means that more and more short-term debt was being used either for investment in fixed

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capital (an investment that pays off only in the longer run) or to extend credit to a firm's customers—a practice that merely builds the debt pyramid and therefore makes the whole credit network increasingly vulnerable to collapse.

The business and banking community, however, counts on a safety cushion: the surplus cash flow generated in the course of corporate activities. This means undistributed profits and depreciation allowances, which are shown in the column of Table 4 headed "Internal Funds Generated Each Year." These are the monies a company expects to use for replacing worn-out equipment, buying machines that will save on labor, expanding capacity, creating a sinking fund for repayment of long-term bonds, and, in an emergency, settling accounts with the lenders of the short-term funds. But here again potential trouble is quite apparent. Look at the last column of Table 4. There we can see that in the 1950s the internal funds generated from year to year were roughly sufficient to cover the accumulated outstanding short-term debt. Now notice how drastically the situation begins to change, especially in the early 1970s when short-term debt was more than twice as large as the internal funds generated annually.

Is there any wonder that the business community begins to cry alarm about a capital shortage just when inventories are huge and a large part of available plant and equipment is lying idle? For what they mean by capital shortage is a deficiency in *money capital.* What is the money capital needed for? To save the corporations from the mess they have got themselves into. And how can one generate more funds to meet the needs of the corporations? Why, raising profits of course.

A further aspect of the present corporate financial picture deserves attention: the growing burden of interest charges (Table 5, p. 16). The first column of this table presents actual net interest paid by nonfinancial corporations. But not all this is a cost to the corporations, since interest is tax-deductible. In column (2) we have therefore adjusted for the tax saving to show the actual cost of interest payments. This more realistic interest cost is then added to after-tax profits to show the total amount of interest plus profits, which is also an ap-

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proximate measure of the corporation's return on its capital.*

What immediately hits the eye in Table 5 is the enormous increase of interest costs in the last 25 years, both absolutely and as a percentage of interest plus profits. As can be seen from column (5), interest costs rose from 2.3 percent in 1950 to 20.4 in 1975. This means that corporations could retain 97.7 percent of their return on capital in 1950 for their own use (dividends, debt repayment, and capital accumulation), but only 79.6 percent in 1975. The other side of the coin is that a larger share of the nonfinancial corporations' return on capital is siphoned off into the financial sector. For the former this is naturally perceived as a further manifestation of capital shortage.

One other point needs to be added in this connection. The figures in Table 5 are for all nonfinancial corporations. But within this category there are wide variations: some corporations are in much better shape than others. Some can meet their debt repayment schedules with an ample margin left over for capital accumulation, while others are in trouble and many (including even some very big ones like W. T. Grant) have already gone over the brink into bankruptcy. These troubled corporations are more than isolated cases; they are weak links in a chain, and the more that break the greater is the danger to the chain as a whole.

As already suggested, the only solution the corporations can see to their capital problems—which really means their liquidity problems—is a substantial increase in profit rates. The thirst for higher profits is obviously always present in capitalist enterprise, but for firms tottering on the brink of bankruptcy or a takeover

* But note that this is *not* a measure of the total surplus value in the Marxian sense which is realized in the corporation. That total would include a large part of executives' salaries, net rent payments by the corporation, most of sales costs (including bribes to actual or prospective customers), and profits hidden under the rubric of depreciation allowances. Some idea of the magnitude of the last item can be gained from the fact that in the depressed year of 1975, while after-tax corporate profits, as shown in Table 5, went down by under one billion dollars, depreciation allowances increased by $11.2 billion from $78.3 billion in 1974 to $89.5 billion in 1975. (See *Economic Report of the President*, 1976, p. 180.)

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Table 5
Interest and Profits
Nonfinancial Corporations

	(1) Net Interest Paid	(2) Cost of Interest Payments[a]	(3) After-tax Profits	(4) Interest Cost plus Profits (2) + (3)	(5) Interest Cost as a Percent of Interest plus Profits (2) ÷ (4)
	Billions of $				
1950	0.9	0.5	21.6	22.1	2.3
1955	1.6	0.8	21.8	22.6	3.5
1960	3.0	1.5	20.3	21.8	6.9
1965	5.9	3.4	37.2	40.6	8.4
1970	15.0	7.6	27.9	35.5	21.4
1974	22.9	13.4	61.1	74.5	18.0
1975[b]	25.0	15.5	60.4	75.9	20.4

(a) Calculated on the basis of the relation between before and after tax profits of corporations in each year, as given in the gross national product accounts.

(b) Preliminary data.

Source: *Survey of Current Business*, various issues, except for preliminary estimate of 1975 profits which is taken from *Economic Report of the President* (Washington, D.C.: Superintendent of Documents, 1976). The net interest payment for 1975 is an estimate based on available data for the first three quarters of the year.

by a stronger corporation the need for more profits becomes a matter of life or death. Even though many of the large corporations are in no such immediate danger, their financial condition is nevertheless drifting in the same direction, and will no doubt continue to do so in view of the stagnation of the overall economy and the unlikelihood of a vigorous new boom in the visible future. So they too have a special sense of urgency these days about boosting profits.

The question, then, is how can corporate profits be increased. One way of course is to increase sales with profit rates remaining stable. But in a period like the present when sales decline or are sluggish on the upside, only higher profit *rates* can be relied on. To the capitalist class this can only mean a mix of the following: holding down workers' wages, still more intense exploitation of labor at the workplace, reduction of corporation taxes, direct or indirect government subsidies, and a free rein to raise prices.

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The open avowal of such goals by capitalists and their spokespeople would, however, be impolitic and counterproductive, so what they do is seek to generate a more receptive atmosphere among the mass of workers and consumers, stressing their supposed solicitude for social needs. There isn't enough capital, they clamor, to get all the energy we need, to clean our air and water, and to raise labor productivity so that more can be sold at home and abroad, and hence more jobs can be created. They say "capital shortage," but what they mean is "profit shortage" and/or insufficient government subsidies to underwrite risky investments and to pay for pollution control. At the same time, to the extent that they convince people that there is indeed a capital shortage, this becomes an argument to reduce expenditures on public housing, health, and other urgent mass needs. After all, since more capital is supposed to be required and since there are limits to the supply, there must be a contraction somewhere in the economy.

One thing is sure, however: this is not meant to be an argument for the elimination of the huge sums of money capital regularly drained off into the financial superstructure. A sense of the magnitude of one such drain—into stock-market speculation—can be obtained from the data in Table 6.

Table 6
New Issues and Total Sales of Stock

	Estimated Proceeds from New Stock Issues	*Total Sales of Stocks on Registered Exchanges*
	Billions of $	
1965	2.2	89.2
1970	8.6	130.5
1971	13.0	185.0
1972	13.1	204.0
1973	11.0	177.9
1974	6.3	118.3
1975*	10.9	165.5

* Estimated by extending the averages for the first eight months of 1975 in the case of total sales and seven months in the case of new issues.
Source: *Survey of Current Business,* various issues.

As can be seen, the new capital raised through the stock markets absorbs only an insignificant proportion of the money operating

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in these markets. At most, as in 1971, the proceeds of new issues accounted for only seven percent of total sales. It is true, of course, that total sales do not provide an accurate measure of the funds tied up in stock speculation, since a given sum of money can effect multiple sales in the course of a year. Nevertheless, it is clear that many billions of dollars are devoted entirely to stock speculation and have nothing to do with the financing or expansion of production.*

The stock market represents only one area into which money capital is diverted. In addition, there is the money capital float in other forms of speculation: various commodity futures markets, foreign exchange futures, puts and calls for common stocks, and—last but not least—real estate. All of these activities, as it happens, are supported and even stimulated by benevolent tax laws. Gains made from transactions that stretch out more than six months are taxed at greatly reduced rates. In real estate an entire financial apparatus has evolved that creates huge tax benefits for the wealthy and at the same time fosters speculation and inflation in land prices and construction costs.

It might be supposed that if there were really a serious capital shortage of the kind we are continually being warned about, the Cassandras would propose basic changes in the tax laws and other measures to deflate the bloated speculative markets. But one does not toy with sacred institutions. Instead, an attack is leveled at government borrowing in the money market. And the way to weaken this presumed pressure on the supply of capital is to cut down on social services at all levels of government: eliminate or reduce services in hospitals, schools, mental institutions, publicly assisted housing, etc. The raid on social services has already begun and, with New York City's financial crisis serving as a scarecrow, is especially stark and demoralizing at state and local levels.

Another ingredient of the package of remedies advanced to cure the presumed capital shortage is a further reduction in corporation taxes. This is shamelessly advocated in the face of the

* It should be noted too that by no means all the money raised through new issues is used for real capital needs, such as plant and equipment. Much of it is typically used for financial purposes, e.g., to pay off outstanding debts or to finance the buying out of other companies.

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fact that the contribution of corporate income taxes to federal revenues has for some time been shrinking. For the data on this, see Table 7. The proportion of federal revenue originating in corporation income taxes declined from 23.2 percent in 1960 to 14.5 percent in 1975. This resulted from several developments: on the one hand the relative increase in social security taxes, and on the other hand the direct lowering of corporate tax rates, as well as concessions made to corporations via more liberal tax-deductible depreciation allowances and the investment tax credit. Clearly, any further reduction in corporate taxation can only be compensated by an increase either in individual income-tax rates or in various types of sales taxes.

Table 7
Contribution of Corporation Income Taxes

Fiscal Year	*Corporation Income Taxes as a Percent of Total Federal Budget Receipts*
1960	23.2
1965	21.8
1970	16.9
1975	14.5

Source: Data for 1960, 1965, and 1970 from *Statistical Abstract of the United States, 1973* (Washington, D.C.: Superintendent of Documents, 1973). Data for 1975 from *Economic Report of the President* (Washington, D.C.: Superintendent of Documents, 1976).

There is, to conclude, a nice and hardly unexpected consistency in the whole capital-shortage affair. First, figures are juggled about and dressed up in seemingly scientific guise. This is then associated with echoes of the energy-crisis scare and the popular pressure for improving and protecting the environment. From these two elements answers are derived that aim, by one means or another, to reduce consumption so that investment can be increased—in spite of the obvious fact that there is little reason for businesses to increase investment if effective demand does not increase substantially. Behind this rickety façade, one can detect the financial morass into which industry and the banks have sunk. The capital-shortage hysteria, in the final analysis, is but the latest ideological campaign to help put the house of monopoly capital in better order—at the expense of the people. (February 15, 1976)

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THE ARABS IN ISRAEL

BY NOAM CHOMSKY

The literature in English on Zionism and Israeli society is extensive, but there are some striking gaps. Within the "green line" (pre-June 1967 borders) one-seventh of the population is Arab. But as the American political scientist Leonard Fein points out, "Unhappily, social scientists have devoted little attention to the Arabs in Israel." This is not to say that American social scientists and other commentators refrain from allusions to the status of the Arab minority. Quite the contrary. One of the great achievements of Zionism is commonly held to be its achievement of the democratic ideal of equality of rights for all citizens. Harvard sociologist Nathan Glazer, a specialist on ethnic minorities with a long-standing interest in Israel and Zionism, writes that "the state created by Zionism is a modern secular state in which civil rights are granted to all people of whatever origin and religion." His colleague, political scientist Michael Walzer, scoffs at Palestinian propaganda in favor of a democratic secular state on the grounds that such

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a state "already exists in substance" in the former Palestine, namely, the state of Israel. These observations are not untypical of left-liberal commentary on Israel. There is general admiration for Israel's secularism and equitable treatment of the Arab minority. The general acclaim is matched only by the no-less general ignorance of the facts.

Perhaps "ignorance" is not quite the right term. Those who extol Israel's "secularism" can hardly be unaware of the degree of religious control over personal life, and they even allude sometimes to the excessive power of religious authority, a minor departure from the ideal. It is well known that there can be no interdenominational marriage in this "secular" state. In the Jewish community, the orthodox rabbinate imposes its interpretation of religious law, with its "black book" of citizens who are not permitted to marry because of "sins" of earlier generations, and so on. To be recognized as a Jew is no small matter in the Jewish state. Where one can live or work, even the opportunity to play in the Israeli basketball league, depends on the decision of the orthodox rabbinate as to who is a Jew, by the criteria that they have established, which require either conversion or a proper genealogy back to four generations. Were similar principles to apply to Jews elsewhere, we would not hesitate to condemn this revival of the Nuremberg laws. But Israel, somehow, remains a secular state by the standards of many liberal American social scientists.

In fact, Israel makes no pretense to being a secular state. Nor is it committed to equal rights for citizens. There is no such thing as "Israeli nationality" in the state of Israel. There is a "Jewish nation" but no "Israeli nation." A citizen is a Jew, a Christian, or a Muslim; his or her life is governed by religious authority and religious law. In this respect, Israel is not unlike its neighbors, which no one would dream of calling "secular states." Syria and Jordan are, by law, Islamic states. Correspondingly, as the Israeli courts have held, Israel is "the sovereign state of the Jewish people," not of its citizens. It is as if the Supreme Court were to proclaim that the United States is "the sovereign state of the white people" or "the Anglo-Saxon people," assigning to some religious or ethnic

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authority the power to determine who qualifies to enter this circle of privilege. As for democratic rights, quite apart from restriction of access to land, work, and public funds, Arabs are still controlled by British Mandatory laws that were condemned by the first Israeli Knesset (Parliament) as "incompatible with the principles of a democratic state." Nevertheless, Israel is ranked high by left-liberal American commentators as an "ebullient democracy" progressing "toward socialism" and as "about as good a model as we have for the democratic socialist hope of combining radical social change with political freedom" (Irving Howe). Meanwhile, its neighbors are quite properly condemned for their religious coercion and adherence to the fundamental principle of discrimination and domination by a selected group.

This disparity in judgment can be placed in a more general context. The American press is regularly disgraced by racist caricatures of "Arab sheikhs" who are bent on destroying Western civilization by raising the price of oil—prominent among them, such "Arab sheikhs" as the Shah of Iran and the government of Venezuela, while Sheikh Yamani of Saudi Arabia, for reasons of his own, hews close to the American line. Comparable references to Jews would be denounced as a reversion to Goebbels and Streicher. We read learned discussions of "the Arab mind," the "shame culture" that prevents Arabs from coming to terms with reality, Arab trickery and deceit and violence, the corruption of the Arab language, in which, we are informed, one can barely tell the truth. It is inconceivable that Jews or Israelis could be discussed in similar terms outside of the literature of the Ku Klux Klan. In contrast, Israel is lauded for its democratic virtues, openness, high cultural values, secularism, equitable treatment of minorities, and progress toward socialism.

Since the overwhelming Israeli military victory of 1967, support for Israel—which in practice generally means support for the more intransigent and chauvinistic elements within Israel—has taken some remarkable forms in the United States, particularly among liberal intellectuals. The reasons for the phenomenon may be debated; the facts are plain enough. Even on elementary questions of civil liberties and human rights,

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Israel enjoys a special immunity, as anyone involved in protest against authoritarian and repressive practices throughout the world will quickly discover. Nothing is easier than to publish a letter in support of a victim of the totalitarian regimes of Eastern Europe. It is quite a different matter when an Arab intellectual is expelled from his or her home in Israel or the occupied territories, or confined to prison under onerous conditions for many months without charges. To cite just one example of Israel's special status for American civil libertarians, consider the interesting case of the Israeli League for Human and Civil Rights, which has been attempting to make public charges of repressive practices within Israel and the occupied territories, calling for investigation, exactly as a civil rights organization should do. In late 1972, the governing Labor Party attempted to take over the group. A secret memorandum headed "Internal—Not for Publication" called on members of the party to appear at the regular meeting of the league, vote its leadership out of office, and control its activities; the Labor Party would pay membership dues. The courts, to their credit, declared the outcome of the meeting where this farce was enacted null and void, though they did require that the league admit the mass membership organized by the Labor Party. Evidently, no small civil-rights organization can long survive such tactics, which would be condemned out of hand in any other state in the world. The response in the United States was indicative of the general mood. Well-known civil libertarians publicly defended the action of the Labor Party, while grossly distorting the factual record (see letters to the *Boston Globe*, April 29, May 17, May 25, June 5, 1973). The International League for the Rights of Man, based in New York, suspended its Israeli affiliate, with no comment on the action of the governing party. Again, the example is quite typical. Given the mood of general hysteria regarding Israel among large circles of liberal intellectuals, it is perhaps not surprising that well-informed and respected commentators can speak of the "modern secular state" of Israel, with its concern for equality of rights of citizens and its fair treatment of the Arab minority.

In fact, in "the sovereign state of the Jewish people" there

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is little hope that Arab citizens will gain equal rights. For the Jewish majority, Israel is comparable in its civil liberties and inequities to Western democracies. But Arabs have no place in the Jewish state, except as a tolerated but essentially foreign element, just as Jews can look forward to no other status in an "Islamic state." In part, the discriminatory structure of the state of Israel is embedded in law and institutions. In part, it is based on administrative practice. There is no substantial segment of Israeli society that opposes or seriously questions the fundamental principle of discrimination, nor is it an issue within world Zionism. As for American "supporters of Israel," they resort to the simplest and most familiar of all techniques: to deny the facts.

The Zionist dream is to construct a state which is Jewish as England is English and France French. At the same time, this state is to be a democracy on the Western model. Evidently, these goals are incompatible. A citizen of France is French, but a citizen of the Jewish state may be a non-Jew, either by virtue of ethnic or religious origin, or simply by choice, because he would prefer to regard himself as merely an Israeli. To the extent that Israel is a Jewish state, it cannot be a democratic state. If the respects in which the state is Jewish are marginal and symbolic, the departure from democratic principle may be dismissed as insignificant. But the state is Jewish in respects that are quite fundamental.

Consider the matter of land use and development, a question of major importance for the Arabs of Israel, largely a peasant population before 1948. Within the green line, over 90 percent of the land is owned by the state or the Jewish National Fund (Keren Kayemeth Leisrael; JNF). Under Israeli law, the JNF controls the Land Development Authority. In its official publications, the JNF describes itself as "the exclusive instrument for the development of Israeli lands." Under its charter, recognized by Israeli law, the JNF is restricted to actions that are "directly or indirectly beneficial to persons of Jewish religion, race, or origin." On lands owned by the JNF, Arabs are not permitted to live or work. These lands are owned in perpetuity by the Jewish people (not the Israeli people, which does not exist as a legal entity). The extent to which the

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JNF applies its discriminatory doctrines is difficult to ascertain. Surely they are taken seriously. For example, ten settlements were recently heavily fined "for illegally leasing agricultural lands to Arabs," the Israeli press reported, while the Ministry of Agriculture is undertaking an "energetic campaign" to eliminate the "plague" of leasing land to Arabs (*Ha'aretz,* July 21, 1975; *Maariv,* July 3, 1975).

Similarly, responsibility for development is assigned in large measure to the Jewish Agency, a quasi-official body that operates in the interests of Jews, with a budget on roughly the scale of the development budget of the government. By such means as these, the state has succeeded in directing resources to Jewish citizens without technically introducing legal discrimination—though in part, as noted, segregation and other discriminatory practices are founded in the legal system itself.

Such principles and practices go a long way toward explaining the systematic deprivation of Arab settlements, including those of the Druze who serve in the Israeli military forces, with regard to such matters as electrification, water resources, and general disbursement of public funds. The extreme inequities introduced by the reliance on quasi-official bodies devoted solely to the interests of Jewish citizens is enhanced by discriminatory distribution of tax funds, a matter that has been brought to light by Knesset member Shulamit Aloni, among others (see *Yedioth Aharonot,* October 10, 1975).

In defense of Israeli secularism, it is commonly argued that Arabs participate in government ministries and agencies and that the General Federation of Workers (Histadrut), long restricted to Jews, now accepts Arab members and participation. It is less frequently noted that Arab officials are to be found predominantly (until recently, and perhaps even today, only) in ministries and agencies dealing with Arab affairs, and that Histadrut programs are overwhelmingly organized for the benefit of Jews. In a recent study, Ian S. Lustick comments that "of the thousands of Histadrut-owned firms and factories not one is located in an Arab village," and that there are still no Arab members of the 18-man Central Committee of the Histadrut and no Arabs among the more than 600 managers and directors of Histadrut-controlled industry. ("Institution-

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alized Segmentation," paper delivered at Middle East Studies Association Conference, November 1975.)

These matters might be considered in relation to the recent United Nations resolution identifying Zionism as a form of racism. This resolution has been universally denounced in the United States. It has been branded "a lie" by commentators who speak of "'the racism of the Arab states," referring to their discrimination against Jews and other minorities, and has been condemned as signaling the virtual demise of the United Nations as a "moral force" in the world. There are ample grounds for condemning the UN resolution, but not those emphasized in the condemnations expressed here. Thus, one might note that the states voting for the resolution are no less guilty of racist practices, in the sense of the resolution, which interprets "'racial discrimination" as discrimination based on "race, color, descent, or national or ethnic origin," as in international conventions. And one might add that Zionism has historically taken many forms, and in an earlier period explicitly condemned the kinds of institutionalized discrimination now practiced by the state of Israel. But there can be no doubt that the text of the UN resolution is technically accurate, in the same sense of "racism" in which we may speak of "the racism of the Arab states." The unending flow of lies and distortion concerning these matters in the United States can only be described as shameful. It amounts to defense of entirely intolerable practices.

If American Jews were excluded from "all-Christian cities" or lands owned and administered by a quasi-official "Christian National Fund," or deprived of development funds, electricity, water, etc., for reasons of religious origin, no one would hesitate to denounce these "racist practices." The reaction would be no different if the United States government or some quasi-official agency responsible for development were to institute a program of "making New York white," modeled on the program of "Judaization of the Galilee," recently revived (the phrase is commonly used, without comment, in the Israeli press, and in publications of the Jewish Agency). I do not even speak of the policies pursued in the occupied territories, for example in the region west of Gaza, where thousands of Arabs

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were expelled, their villages destroyed, the area restricted to all-Jewish settlement, including agricultural cooperatives and the new all-Jewish city of Yamit recently opened on the Egyptian side of the internationally recognized border. In these areas, Arab political activity or organization is suppressed, people are jailed or expelled without charges, there are collective punishments, etc. Within Israel, there has been protest against these actions. In the United States, again, the reaction on the part of "supporters of Israel" is quite different.

An international consensus is developing in support of a two-state settlement in the former Palestine, with a Palestinian state in the West Bank and Gaza strip alongside of Israel. The UN Security Council resolution of January 26, 1976, vetoed by the United States, called for the establishment of "an independent state in Palestine" beyond the green line, with a guarantee for "the sovereignty, territorial integrity, and political independence of all states in the area and their right to live in peace within secure and recognized boundaries"—including both Israel and the Palestinian state. Within the Palestine Liberation Organization (PLO) there has evidently been considerable debate about the merits of such a settlement. Various opinions have been publicly expressed. Sabri Jiryis is one of those who has advocated a two-state solution; others have expressly rejected it. A joint Moscow-PLO statement in November 1975 called for a "national state" for the Palestinian people, established "according to UN resolutions," which uniformly call for security and integrity of all states in the region. The Jordanian press has commented that the Palestinian reaction to the January 1976 Security Council resolution constituted "an implicit recognition of the right of an Israeli state to exist," and the same might be said of the Moscow communiqué. Within Israel, there is some articulate support for a settlement along these lines, though the government has not modified its adamant and total rejection of any political settlement that grants the Palestinians national rights and national independence, and flatly rejects any political negotiations with Palestinians.

The United States is now quite isolated in opposition to the general international consensus, but it is likely that American government policy will shift. The United States government

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has no abiding commitment to the current policy of Israel, with its dual aims of maintaining control of substantial parts of the occupied territories and crushing Palestinian nationalism. It is an open question whether Congress will continue to authorize the substantial aid that Israel requires to preserve its economy under the conditions of military confrontation, though the matter is complicated by the fact that the "costs" of the Middle East arms race bring substantial "benefits" to American arms producers.

Suppose that in the course of time a political accommodation is achieved, along the lines of the emerging international consensus. This is not impossible, though a realistic estimate might assign it a lower probability than continued military confrontation and an eventual destructive war. If a two-state settlement is imposed by external force (it is difficult to conceive of another mechanism, under current conditions), there will be two small states in the former Palestine: Israel, by the standards of the region, a powerful and advanced industrial society; and a Palestinian state, virtually a dependency, contained within a tacit Israeli-Jordanian military alliance. It is plausible to suppose that the Palestinian state will be a mirror-image of Israel in its internal structure and practices. If so, there will be two states, one weak and the other powerful, each founded on the principle of discrimination against the national minority.

The prospect is hardly an attractive one, though one might argue that there is no preferable alternative under current conditions. It is possible that under conditions of peace, the problems of discrimination and oppression might then be faced by groups within the two hostile societies that are committed to civil rights and socialist principles. Such groups might seek to establish relations along other than national lines—specifically, along class lines. They may try to find a way to work together to combat oppressive institutions and to develop new political forms, within a socialist framework, that will permit national self-determination without domination of one group by another. In such an attempt, they can find historical antecedents, for example, within the pre-Second World War Zionist movement and the Palestinian Communist Party of that period.

There was a time when Zionist leaders could warn against

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a realization of Zionism "in the form of the new Polish state with Arabs in the position of the Jews and the Jews in the position of Poles, the ruling people," a "complete perversion of the Zionist ideal" (Berl Katznelson of Mapai, since 1948 the governing party in Israel, in 1931). This "complete perversion" has in fact been the historical realization of Zionism. It has, quite naturally, been accompanied by a relative decline in the socialist institutions of the pre-state Jewish settlement, exactly the opposite of the "'progress toward socialism" perceived by American observers. Perhaps it is not too much to hope for a revival of the binationalist socialism of an earlier day, if the bitter national conflict recedes. It is surely the task of the left—among Israelis, Palestinians, and internationally—to work for that end, whatever the strength of the forces committed to oppression, exploitation, exclusivism, and domination.

The problems of multi-ethnic societies are enormously complex. In most parts of the world, they have defied satisfactory resolution, seriously impeding the development of socialist internationalism. Under conditions of war and national conflict, they are virtually insuperable. Partisans of one or another side take comfort in denouncing the crimes, often real enough, of their enemies, constructing an imaginary world in which their favored group is merely the victim of forces beyond its control and enemies that seek to destroy it. Israel faces real and undeniable problems of security. I believe that the policies of the government since 1967 have contributed significantly to what may prove a national catastrophe. But as any rational observer must agree, the Palestinian people have already suffered a national disaster. In their former home, they are an oppressed minority; elsewhere, they are scattered refugees. Many crimes have been committed on all sides. Continued national conflict simply leaves the fate of the warring parties in the hands of the imperial powers, which will be concerned, as always, with the interests of their own ruling groups. In the Middle East, the United States is by far the dominant external force, as it has been since the Second World War. Policies that it undertakes are of crucial importance.

Without succumbing to pluralist mythology, we must nevertheless recognize that popular opinion and organization do

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play some role in influencing state policy, or at least the manner of its execution. At certain historical moments, they can exert a significant influence. The stakes, in this case, are extraordinarily high. For Israeli Jews and Palestinians, the stakes are no less than survival. Others in the region have suffered bitterly in the course of the conflict and can look forward to a fate still more grim, if it persists. Given the strategic and economic significance of the neighboring regions, the international ramifications will continue to be profound and far-reaching. Whatever one's attitudes and commitments, it will not hurt to become acquainted with some of the basic facts.

Sabri Jiryis has done work of unique significance in presenting some of the basic facts that are generally little known and often willfully ignored. His work is careful, documented, and judicious. He deals with that central and crucial domain that has been so neglected by social scientists and others who have produced the extensive literature dealing with the state of Israel. The appearance of his study on the Arabs in Israel, in a new and much expanded version, is an occasion of great importance for those who hope to go beyond propaganda to an understanding of the world of social and historical fact. While his study of course by no means exhausts the important questions to which it is addressed, it should raise discussion and understanding of these issues to an entirely new level. If there is a political accommodation along the lines of the two-state settlement that Jiryis has advocated, then his study will gain new and greater significance as attention turns, we may hope, to the basic problems of discrimination and oppression that are submerged in the violence of national conflict and preparation for war.

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FREEDOM RAILROAD

BY MARTIN BAILEY

Almost a century ago Cecil Rhodes dreamt of a Cape-to-Cairo railroad that would slice open the African continent to British imperial rule. The transcontinental link was never built, and the section between the Zambian Copperbelt and the Tanzanian port of Dar es Salaam remained uncompleted until 1975 when—thanks to Chinese assistance—the last length of steel track was lowered into place to provide a rail outlet for Zambia through independent Africa.

Eleven years ago the state of Zambia was born. But although political freedom had been won, the new nation was economically dependent on its neighbor, white-ruled Southern Rhodesia, since virtually all its foreign trade was hauled by Rhodesia Railways to the port of Beira in Portuguese-controlled Mozambique. Rhodesia's Unilateral Declaration of Independence (UDI), barely a year after Zambia had celebrated its first anniversary of independence, increased the dangers of dependence on Salisbury. Not only did the Zambian government begin to impose sanctions against the rebel regime by gradually reducing economic links, but it also supported the liberation movements which were struggling for majority rule.

The dangers of dependence on the traditional rail route to the south were demonstrated on January 9, 1973, when Ian Smith pulled down the barriers over the Victoria Falls Bridge—on the grounds that Rhodesian guerrilla fighters were operating from Zambian bases—thereby cutting off Zambia's

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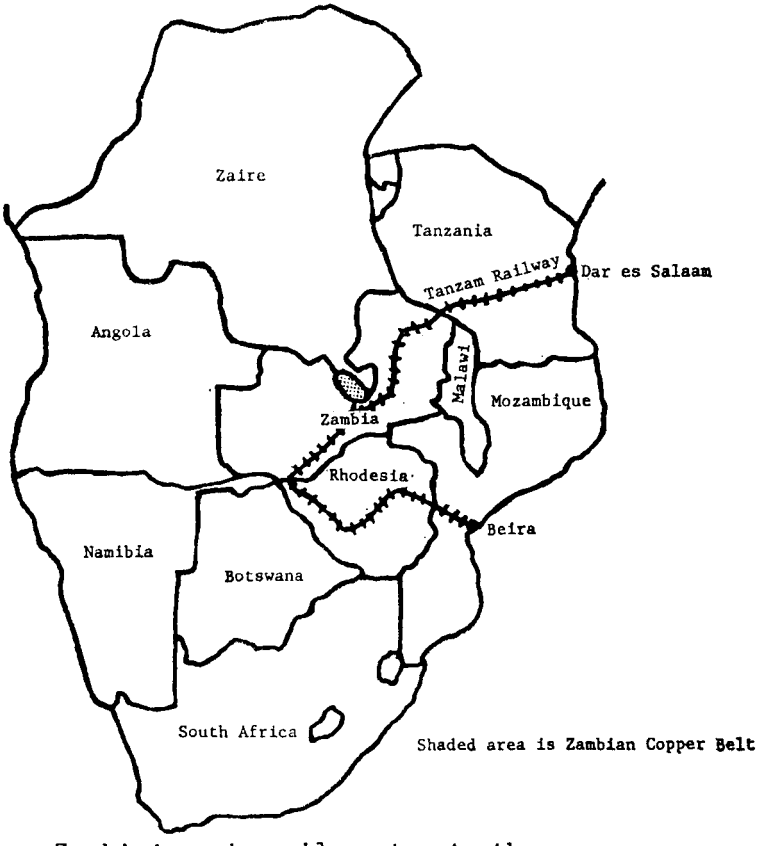
outlet to the sea. But the Zambian government—since construction of the Tanzania-Zambia (Tanzam) railroad was well under way—was determined to resist Rhodesian pressures and to develop emergency routes until completion of the new rail link to Dar es Salaam. Smith's attempt at blockade backfired and, as President Kaunda remarked, it was Zambia's "golden opportunity" to make a final break with the racist regimes of Southern Africa.

With the independence of Mozambique, in June 1975, and the increased likelihood of a Rhodesian settlement, the strategic reasons for the construction of the Tanzam railroad



Zambia's main rail routes to the sea

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became less pressing. But there remain strong economic arguments for a rail connection between the Copperbelt and Dar es Salaam. Vast areas of Tanzania and Zambia, which had lain neglected because they had been poorly served by transport facilities, are likely to be opened up. Rich agricultural lands, especially in Tanzania's Southern Highlands and Kilombero Valley, should be developed. Mineral deposits in southern Tanzania—particularly coal and iron ore—are to be exploited, and China has already pledged a loan of $74 million toward opening the mines. This is likely to lead to the establishment of a heavy-industry sector in Tanzania and consequently to a structural development of the country's economy. Finally, the completion of a cheap transport link between Zambia and Tanzania will improve prospects for increasing trade between the two countries.

In Africa the new line is known as the *Uhuru* (Freedom) Railroad, rather than by the politically neutral Tanzam tag, and the project could well have an important impact in enlarging the independence of the two states. The nationalist leaders of Tanzania and Zambia first became interested in the railway during the early 1960s, when it was already clear that the project would be too expensive to be built without foreign assistance. In 1964 the British company of Lonrho studied the scheme, and this was followed a few months later by an investigation by the World Bank. Requests were submitted to major Western aid donors—the United States, Britain, West Germany, and France—as well as Japan and the Soviet Union. A number of multinationals, such as Kaiser Engineers, saw a golden opportunity in a railroad of this magnitude, and there was talk of an international consortium being formed by a group of companies.

Numerous reports and surveys were commissioned, and the project threatened to become buried under the weight of all the paper that it generated. But in the end the West, which saw little need for Zambia to break away from its dependence on Southern Africa, was reluctant to put such a large sum of money into a single development scheme. The scene was set for China to embark on its most ambitious move into Africa.

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Kao Liang was among the swarm of foreign journalists who descended on Dar es Salaam to cover the country's independence celebrations at the end of 1961. In one of his early dispatches, the correspondent of the New China News Agency recalled that it had been Chinese workers who had helped build the colony's first railroad just over half a century before. The German colonialists had imported a thousand coolies, and the camp where they stayed was apparently renamed Shanghai Village. Kao can hardly have imagined, as he cabled his report, that within a decade 15,000 of his compatriots would be constructing a new line from Dar es Salaam.

While the original railroad built by the Chinese in 1906 served to open up East Africa to European colonial rule, the new Tanzam line represents an important step toward the economic and political independence of the two countries. Whereas the German colonialists had imported coolies from a poverty-stricken China, today the Chinese government has been able to provide an interest-free loan of $400 million to build a railroad into the heart of Africa.

China probably first considered the Tanzam project in 1964. The year began with Chou En-lai's celebrated safari across Africa, taking him to ten nations, and it was on this tour that the Chinese leader announced the Eight Principles governing the provision of aid from China. This was an attempt to differentiate Chinese aid from the assistance provided by Western and Soviet donors. The year 1964 also saw the independence of Zambia, and this brought a new sense of urgency to the rail link.

"I don't care whether I get communist or Western money," President Nyerere snapped to reporters, "I want this railway and I'm not going to be stopped." Already by 1965, when Nyerere paid his first visit to Peking, it was becoming clear that there was little real Western interest in the Tanzam project. In June Chou En-lai returned the visit to Dar es Salaam, and within a few weeks a small group of Chinese surveyors arrived in Tanzania to make a preliminary study of the railroad. But the team did not cross over into Zambia because Kaunda's government was initially suspicious of China's motives. Over the next two years Zambia took more interest in the Chinese

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offer, partly as a lever to encourage a Western bid, and Rhodesia's UDI made the railroad even more important for landlocked Zambia.

When Kaunda paid his first visit to Peking in June 1967 he left, like Nyerere before him, very impressed with the developments that were taking place in China and more convinced of the honesty of the Chinese leaders. Colonially-inherited Yellow Peril/Red Menace fears receded, and three months after Kaunda's visit a preliminary agreement was signed by Chinese, Tanzanian, and Zambian ministers, in which China undertook to finance and build the railroad. The fact that this document was signed at the very height of the Cultural Revolution suggests that decision-making had certainly not ground to a halt in Peking. A full survey of the route was begun in May 1968, and by the time the final agreement was signed in July 1970 preparatory work for constructing the line had already begun.

The Tanzam railroad has been China's largest aid commitment, as well as the most expensive development project undertaken in Africa since the Aswan and Volta Dams. "We are the more appreciative," Nyerere told his hosts during a visit to Peking, "because we realize that this capital is not surplus to your requirements, nor are your technicians otherwise unemployed." Some forms of Western aid are provided to stimulate industrial production in the donor country. But for China, with an economic system which fully employs its human and material resources, this was certainly not a consideration in building the Tanzam railroad. So why did China undertake to finance the project? Or to look at the question in another way: Why did China lay more than a thousand miles of railroad track in Africa, rather than in her own vast country which still has a relatively underdeveloped transport system?

The main aspect of Chinese foreign policy since the 1960s has been opposition to the two superpowers, and Peking has regarded the Third World as a crucial Intermediate Zone between the United States and the Soviet Union. Strengthening the new African nations so that they are in a better position to resist pressures from Washington and Moscow has therefore been considered an important priority of China's foreign policy.

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The Tanzam railroad offered a unique opportunity to assist progressive forces in Africa. The line will reduce Zambia's dependence on the white South, enabling the government to give greater support to the struggle for majority rule, while good relations with Lusaka and Dar es Salaam provide China with access to the offices of the liberation movements. Tanzania, by most criteria, has one of the most progressive governments on the continent. The railroad should also open up new opportunities for development and help reorient the economies of the two African states away from the distorted patterns inherited from the colonial period. China's decision to assist with the Tanzam project represented a commitment to the forces of change in Africa.

Even before the railroad was seriously discussed, the Tanzanian and Zambian governments had shown themselves sympathetic toward Peking. Both countries had established diplomatic relations with the People's Republic, rather than with the regime on Taiwan, while consistently attacking the U.S. attempts to isolate China and treat the earth's largest nation as an international outcast. It was, after all, the Tanzanian representative at the UN who—much to the anger of President Nixon—"danced" in the aisle of the General Assembly after the historic 1971 vote that brought China into the world body. The two African states did not support Chinese interests because of their wish for assistance with the railroad, but China was naturally much more willing to aid countries which backed the rights of the People's Republic.

"Red Guard Line Chugging into Africa," ran the headline in the *Wall Street Journal,* and newspaper editors vied with each other to produce the most horrifying predictions. Southern Africa and the Western world, angry that China had established a "presence" in territories which had previously been considered their preserve, warned of the dangers of accepting Chinese assistance. Peking was accused of tying political strings to her aid, and over the next few years a constant series of anti-Chinese stories were circulated in an attempt to discredit Peking.

One typical example was a forged photograph that was probably released by the CIA. The picture, which purported

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to come from the official New China News Agency, was published in several African newspapers just two weeks before construction began. It showed a group of Chinese gathered around a poster, headed "The Promised Land," which called for volunteers to work on the railroad in Tanzania. Those who wished "to settle in Africa after the said task is complete," the poster continued, "will receive good land and a house for themselves and their families." As the railroad snaked its way from Dar es Salaam, stories of settlers rose to new flights of fantasy—one Nairobi newspaper reported rumors that ten million Chinese women would be sent to Tanzania to grow rice for China—in an attempt to stir up anti-Chinese feelings along the route where the line was under construction.

Hostile observers also alleged that the Chinese were building the project in return for military facilities in East Africa. Over the last decade there have been constant reports that China is setting up telemetry equipment in Zanzibar to monitor the testing of an intercontinental ballistic missile. But a recent American military report admitted that "it is no breach of security to say that it appears that the [missile-tracking] station is a figment of newsmen's imagination." (*Communist China in Black Africa,* Carlisle Barracks, 1971, p. 18) In fact no political ties appear to have been attached to China's aid for the Tanzam project.

Warnings from Southern Africa and the Western world about the dangers of assistance from China reflected a belief that the newly independent African states were incapable of looking after their own interests. This attitude—patronizing at best, and often rather more sinister—implies that outsiders know what is best for Tanzania and Zambia. "I have noticed one rather odd thing about international reactions to this railway project," Nyerere once remarked, and this is a frightening self-revelation of Western attitudes which "implies that in their view aid is always an instrument of domination." Tanzania had already, in fact, experienced a number of occasions when assistance from the West had been blatantly employed as a political instrument. Britain, West Germany, and the United States had all withdrawn or reduced aid to Tanzania because of a number of foreign-policy decisions taken by Nyerere's government.

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On the other hand, there is no evidence that Chinese pressure ever led the Tanzanian or Zambian governments to pursue policies—either internally or externally—which they would not otherwise have adopted. Many aspects of the foreign policies of the two African states coincide with Chinese interests—such as support for Peking's membership in the UN, assistance to the liberation struggle in Southern Africa, and opposition to American aggression in Vietnam—but on these issues Dar es Salaam and Lusaka would no doubt have adopted these positions even in the absence of aid from China. All three countries are members of the Third World and consequently share similar viewpoints on many questions.

The Chinese survey of the Tanzam railroad revealed that the line would cost $400 million. An interest-free loan was provided for this amount—if actual costs are higher, which is very likely, the excess will be met by Peking as a grant—and it will not have to be repaid completely until the year 2012. The railroad, as the Tanzanians and Zambians have said, will be paid for by their grandchildren. Chinese aid is unique in that it provides for a semi-automatic form of debt re-scheduling: if payments prove to be too heavy a burden on the economies of the two African states, Peking will consider extending the repayment period. The terms of the Tanzam loan are therefore particularly generous and are much softer than those of most Western or Soviet aid.

One of the features of the Tanzam project has been the high proportion of locally-incurred costs—for material, transport, and above all for wages—which in most aid schemes are borne by the recipient. Local costs of the railway were estimated at 52 percent of the total, just over $200 million, and it would have been difficult for Tanzania and Zambia to provide the funds. China, however, is short of foreign exchange—until 1973 her total foreign trade was actually less than that of Taiwan—so it would have been a heavy burden for Peking to finance the local costs in cash. A commodity credit arrangement was therefore agreed upon whereby Chinese goods were provided on a credit basis to Tanzania and Zambia, where they were sold through the state trading corporations, with the proceeds used to defray local costs. China's trade with the two African states, which was nonexistent in the early 1960s,

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has leapt up, and in 1971 China replaced Britain as Tanzania's largest source of imports. Chinese goods, ranging from chewing gum and toy machine guns to bicycles and agricultural equipment, are now widely sold throughout Tanzania and Zambia. Virtually every tiny village store carries at least a few goods from China on its shelves.

When the commodity credit arrangement was announced it aroused a great deal of criticism from traditional suppliers of the Tanzanian and Zambian markets, who rightly feared that their position was being threatened. It was said that it would be difficult for the two African countries to absorb such large quantities of Chinese goods, because they would either prove to be of inferior quality or would compete with locally made products, but these fears do not appear to have been warranted. Nevertheless, aid for the Tanzam project was clearly "tied" to the use of Chinese equipment and manpower for the actual construction and to the import of goods from China to defray the local costs.

An American "China-watcher" posted to the Tanzanian capital in the early 1970s apparently spent much of his time staring out of his embassy window, conveniently located on the harbor front, watching the stream of Chinese ships which entered the congested port. The view was "impressive, if depressing," commented the American diplomat. Probably a total of 50,000 Chinese workers disembarked over the year, and 500,000 tons of equipment and supplies were unloaded onto the crowded quay. Soon convoys of Chinese lorries began to rumble down the Great North Road, which had just been rebuilt with American assistance. Almost all the road signs along the route were painted in red Chinese characters—an incongruous sight in the African bush—which directed drivers to the construction camps.

Laying a railway line from Dar es Salaam 1,155 miles into the heart of Central Africa presented a major engineering challenge. More than 90 million cubic yards of earth, equivalent to a wall one yard high and wide encircling the globe three times, was excavated before the tracks reached the Zambian terminal of Kapiri Mposhi. The route climbs up from sea level to almost 6,000 feet, in order to ascend the rift valley escarpment; and the skills of the Chinese engineers were put

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to the test: hillsides were sliced away, bridges suspended over ravines, and tunnels threaded through mountains.

The most striking aspect of the actual construction of the railroad was the huge labor force involved. At one time 45,000 Africans and 15,000 Chinese were employed. Western-financed projects generally use much smaller numbers of workers, but make considerably greater use of expensive equipment and complex technology. The World Bank, which had previously prepared a feasibility study of the railroad, suggested that only 1,500 men would be needed. The Chinese, in fact, employed *fifty times* this number.

Labor-intensive methods are usually more suitable for developing countries which suffer from a shortage of capital. Through the construction of the Tanzam railroad, paid employment was provided to a huge number of people for the first time in their lives. At one time the number of Tanzanians on the project represented one seventh of the nation's paid labor force and one percent of the male population. Part of their wages were spent in the area where the line was under construction, with the remainder normally being sent back to their families, and the injection of this additional cash into the economy acted as an important economic stimulus in the rural areas.

The railroad, commented the Zambian *Daily Mail*, is "a vast school wherein Zambians and Tanzanians are given an opportunity to acquire valuable and rare skills whilst earning a living." A strong emphasis was placed on training, usually on-the-job instruction rather than more formal teaching in a classroom setting; and this should have a positive long-term impact. It is expected that the railroad will be largely run by Tanzanians and Zambians, with perhaps only a hundred or so Chinese experts being required to stay on, once construction is completed.

Altogether almost 100,000 African workers were employed on the railway, and many of these men now have useful skills, ranging from driving to bridge-building. The use of labor-intensive techniques, which was less expensive than using complex capital equipment, undoubtedly has had positive spin-offs for the economies of the two African countries.

"The railway will be of tremendous value to my country

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and free Africa," Nyerere recently remarked, "but the example of hard work and selfless service, which is being provided by the Chinese comrades who are acting as technicians and teachers on the railway, may be of equal importance for Tanzania's future development." Chinese experts in the Third World behave very differently from their Western and Soviet counterparts, and this has played an important part in making aid from China more acceptable to the developing countries.

Western and Soviet technicians tend to work in a directing capacity in the Third World and take little part in the actual work itself. They have a standard of living usually considerably higher than they would have at home, and frequently foster elitist tendencies in the society in which they are living. The Tanzanians and Zambians—who have seen too many expatriates coming to "develop" their country from the comfort of air-conditioned offices and luxurious villas—are certainly very conscious of the different style of the Chinese.

The Chinese railway engineers took part in much of the manual work on the Tanzam project, believing that intellectual and physical work should not be separated, and the team leaders from China could often be seen wearing the same gray overalls and wielding shovels along with their colleagues. The Chinese lived austerely, in a style similar to that of Tanzanian and Zambian laborers, and no special conditions were requested. This point was vividly made by Chou En-lai when he talked with a group of Chinese departing for the Third World: "If you die there, do not ask for special treatment; just have the corpse cremated, and don't let them put up a plaque in your honor." Tanzanian and Zambian ministers attended the funeral of three Chinese workers who were killed in a road accident, a mark of respect that few Western experts have received.

During the period when the Chinese were surveying the rail route, in 1968-1969, the surveyors distributed propaganda to the local people until the Tanzanian and Zambian governments made it clear that this was unwelcome. After the Cultural Revolution, which ended at about the time actual construction began in 1970, the Chinese technicians on the Tanzam project kept a very low profile, and there were few if any instances of any overt politicization. Indeed by 1974 the propa-

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ganda was flowing in the opposite direction. Catholic missionaries in Zambia distributed two pamphlets in Chinese—a small red-covered edition of the Gospel according to St. John and the Thoughts of Jesus—leading the Chinese ambassador in Lusaka to protest that if they didn't distribute their Red Book to the Zambians he didn't see why the Catholics were allowed to hand out publications to the Chinese workers.

Even if there has been little direct politicization by the Chinese technicians, it is clear that their example has had an impact on their African colleagues. "If it were possible for me to lift all the ten million Tanzanians and bring them to China to see what you have done since liberation, I would do so," Nyerere told his hosts during his first visit to Peking. Bringing 15,000 Chinese to Tanzania may have been seen by the Tanzanian president as a more feasible proposition, and hope of learning from China's experience has probably been regarded as a useful spin-off from the Tanzam project.

The Chinese model of development has been a source of inspiration in Tanzania and Zambia. Nyerere and Kaunda often mention the hard work and the frugality they have observed in China as well as the Chinese emphasis on rural development and self-reliance as important examples for emulation. One can question, of course, whether Chinese practices can have much relevance in other societies which have not embarked on the same revolutionary path. But for Tanzania and Zambia, which had previously been brought up with the Western model of development, exposure to Chinese methods is likely to have a healthy impact on attitudes and policies.

Work on the railroad proceeded quickly, with the last section of track joining the Tanzam route with the Zambian rail system laid in June 1975, the line being finished more than two years ahead of schedule. Early completion is an unusual event in a Third World country with an underdeveloped infrastructure to handle such an enormous project. Progress on the railroad was inevitably compared with improvements that were made to the Great North Road, which runs from Dar es Salaam—almost parallel to the new railroad—to the Zambian Copperbelt. After UDI the road became an important outlet

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for landlocked Zambia and the dirt track, dubbed the "Hell Run" by the truck drivers who used the route, was upgraded by Western aid donors. The section built by the Americans was finished more than six months behind schedule and consequently the efforts of the Chinese and the Americans were likened to the fabled race of the tortoise and the hare—with the technologically inferior Chinese playing the role of the victorious tortoise.

The last decade has witnessed a growing disillusionment with Western and Soviet aid—both among recipients and donors—and an increasing interest in Chinese assistance as an important alternative for the Third World. The fact that the Tanzam railroad is already operational, just five years after construction began, is a glowing advertisement for aid from China. But, as Nyerere constantly stresses, "it will not be a Chinese railway." It is a Freedom Railroad—a railroad for African liberation. To what extent the project lives up to its name will be a responsibility of the governments and peoples of Tanzania and Zambia.

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BOOKS

ON THE CZECHOSLOVAK REFORM MODEL

By Paresh Chattopadhyay

The Human Face of Socialism: The Political Economy of Change by George Wheeler. Westport, Connecticut: Lawrence Hill, 1973. $7.50.

The Czechoslovak Reform Movement 1963-1968: A Study in the Theory of Socialism by Benjamin B. Page. Amsterdam, 1973. $11; paperback, $8.

The Czechoslovak reform proposals preceding the events of August 1968 have been the subject of a wide and passionate debate. Hostile criticism has been more or less matched by enthusiastic comments. But both pros and cons frequently suffered from a lack of careful analysis of the proposals themselves. Two recent books have, however, attempted to delve beneath the surface in a serious effort at analysis.

In what follows, we first give a brief account of the contents of the books and then offer our own critique. We shall be concerned with the books only to the extent that they discuss the *theory* underlying the reform proposals.

I

Page begins his book by providing a sketch of contextual settings in which, from 1965 through January 1968, and from January to August 1968, the reformers within the Communist Party of Czechoslovakia sought to implement their reform models. During this whole period the forces of economic, managerial, and

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technological reform had been developing within the Party and the Czechoslovak Academy of Sciences. The economically disastrous year of 1963—when the rates of growth of national income, industrial production, and investment in Czechoslovakia fell by 3.2 percent, 0.7 percent, and 11.9 percent, respectively—was the point of departure of the establishment, in succession, of three investigating commissions concerning the economic difficulties, the consequences of the introduction of mass-scale science and technology into production, and the development of political models for a socialist state undergoing the introduction of mass-scale technology. Corresponding to these three problems were the three central works: *Plan and Market under Socialism* by Ota Sik, *Civilization at the Crossroads* by R. Richta, and *State and Man* by Z. Mlynar. These works were synthesized and concretized in the *Action Program* of the Communist Party of Czechoslovakia, issued in the spring of 1968. The purpose of Page's book is to investigate the so-called "reform model" of socialism as embodied in these works.

As a useful prelude to this task, the author, in the first chapter, very succinctly analyzes the forces responsible for the fall of the Novotny leadership and the rise of the Dubcek leadership in the Party. Then, pursuing his central theme, he discusses the economics and the politics of the reform movement in the second, third, and fourth chapters of the book. In the fifth chapter the *Action Program* itself is analyzed. The remaining four chapters are devoted to a critical review of the movement as a whole, taken in the sense of a "theory of socialism."

As to Wheeler, he begins his study with the assertion that a socialist society with central planning and proletarian dictatorship inhibits social change to a greater extent than does capitalism. In the second chapter he sketches the political and economic history of Czechoslovakia up to the events of February 1948 and the establishment of "socialism." In the third chapter he traces economic growth under the new regime and assesses positively the role of central planning in the early years. However, as he notes in the fourth chapter, in the course of time the economy began to face great difficulties—investment efficiency and labor productivity showed marked tendencies to decline. These difficulties, he maintains, were due to the failure of centralized management of the economy. This failure in turn is traced, in the fifth chapter, to several factors—elimination of market competition, favoring quantity over quality, lack of proper material incentives, etc. In the sixth chapter he attributes the dissatisfaction of the Czechoslovak people

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with the regime to two things: the centralized management of the economy, and the dictatorial use and abuse of political power. This is followed, in the seventh chapter, with a general description of the reform proposals, special stress being laid on their economic side. The author ends the book by deploring the intervention of the Warsaw Pact powers.

The two books differ from each other in two important respects. First, while Page gives a comprehensive picture of the theoretical content of the reform movement, Wheeler offers only a partial picture, confining himself mostly to its "political economy," which of course is his ostensible purpose. Second, while Wheeler explicitly espouses the position of the reform movement, Page on the whole is very critical of it.

II

Let us first examine the economic content of the reform movement. The difficulties of the Czechoslovak economy were, according to the movement, due to its incapacity to shift the structure of production from "extensive" to "intensive" growth, that is, from a quantitative expansion of inputs to a qualitative development of technology, labor productivity, investment efficiency, etc. This incapacity, in its turn, was due to the lack of sufficient incentives for enterprises to make the shift, given the centralized administrative control of the economy. What was necessary, so the argument ran, was not the elimination of planning but its functioning as a broad macro-economic coordinator of different investment projects. At the same time, the market should be promoted as the main allocator of resources, while the profit of the enterprises should act as the principal stimulus to economic efficiency. Moreover since the system of "administrative planned management," by putting accent on quantity rather than quality and on production for production's sake, had failed to satisfy the growing and diversified needs of consumers, it was necessary to emphasize, according to the reform movement, that the purpose of production was to satisfy these needs in the best possible way, and it was precisely the market which was to perform this task. In a word, centralized "administrative socialism" was to be replaced by a decentralized "market socialism."

What does all this amount to? After the liberation from fascism, Czechoslovakia, like most other countries of Eastern Europe, had almost blindly applied the Soviet centralized planning model. This model, as Wheeler points out, on the whole served the needs of the Czechoslovak economy in the first years after

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liberation. There is, however, no denying the fact that in the course of time, with the development of the economy, the centralized model showed itself on various counts incapable of dealing with the high level of productive forces which had by then been attained: the center was overwhelmed by the number and complexity of the problems, leading inevitably to increasing bureaucratization of the state apparatus, to directives having a restrictive and contradictory character, resulting in rising costs of production, very little encouragement to technical innovation, and lack of elasticity of the structure of production in relation to the needs of society. Perhaps most important of all from a socialist point of view, the plan reflected only the preferences of planning authorities and not at all those of the masses, except theoretically, as the latter had no means of direct participation in the planning process.

An examination of the standpoint of Sik and his associates in the sphere of political economy—accepted *in toto* by Wheeler—starts from an analysis of their position on the question of commodity production. There are two essential points in this position as summarized by Page and emphasized by Wheeler. First, Marxists, always associating commodity production with private ownership in the means of production, have traditionally (up to and including Stalin) denied the existence of commodity production under socialism, which is characterized by public ownership of the means of production. Second, commodity production and consequently the market have nevertheless continued to operate after the replacement of capitalism by socialism and remain essential elements of socialism. It follows that centralized administrative planning, by trying to suppress commodity market relations under socialism, denies a vital "objective necessity." The conclusion emerges that it is necessary to introduce decentralized "market socialism."

Let us examine these arguments.

III

First, what Sik and his associates call the "traditional Marxist view" does not always and invariably associate commodity production with private property in the means of production. According to this view, private property in the means of production is *not* an essential precondition of commodity production. What is essential for "objects of utility" to be turned into commodities is that they should be "the products of the labor of private individuals or groups of individuals who carry on their work *independently* of each other." (Marx, *Capital*) Thus commodity production

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exists under public as well as private ownership of the means of production as long as production is carried on in independent units or enterprises. This is of course true of capitalism, but it is also true of the transition period between capitalism and socialism, which is characterized by a certain structure of the relations of production and the forces of production such that the different processes of production can be dominated only separately at the level of the diverse units of production, the absence of private property in the means of production notwithstanding. All Marxists worthy of the name have implicitly or explicitly accepted this. What they *have* denied is the existence of commodity production under socialism—understood in the sense of Lenin as the "abolition of classes"—which can come only *after* the dictatorship of the proletariat (the political regime of the transition period) has fulfilled its historic tasks. As a matter of fact, we know that the transition between capitalism and communism (including socialism, its first phase) combines the features and properties of both systems. Commodity production, division between mental and physical labor (reflecting the social separation between theory and practice), opposition between the town and the countryside, the wage system, etc., continue to exist during this period not as elements of socialism but as the *remnants* of capitalism. The task of the dictatorship of the proletariat—which is the *continuation of class struggles under a different form*—instead of perpetuating these remnants, as certain economists of Eastern Europe professing Marxism would like to have us believe, is precisely to set in motion the processes that will *weaken* and, in the long run, *eliminate* them along with exploitation and the state, the repressive machinery of the ruling class.

Sik and his associates (whom Wheeler faithfully follows) never clarify what they mean by socialism. Any clear discussion in their writings about the necessity of a transitional period between capitalism and socialism and exactly what it signifies is also hard to come by. But from the context of their analysis one would perhaps not be far wrong in assuming that according to them the seizure of political power by the proletariat and the abolition of private property in the principal means of production—in the juridical sense—is tantamount to socialism. It is in this kind of "socialist" society that commodity production, according to them, is an "objective necessity." (It is interesting to note that Stalin, contrary to what they say—including Wheeler who says this in at least three places of his book—*did* assert the existence of commodity production under socialism, basing himself on arguments, earlier used

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by Preobrazhensky, that are in some important respects similar to those advanced by the reform movement.)

The whole argument suffers from a confusion between the *juridical* and the *real* relations of production. Abolition of private property in the means of production is a juridical act by the proletarian state and it does not *ipso facto* mean the abolition of capitalist *relations* of production, without which there is no socialism. Under the capitalist mode of production itself there comes a stage when private property in capital—in the juridical sense of the term—is abolished. The logic of concentration of the means of production and of labor power at a certain stage in the development of capitalism forces the capitalist class to put these means of production first under the joint stock companies and finally under the direct ownership and control of the state. Thus capital no longer remains private; it becomes in Marx's phrase, "social capital." "This is the abolition [*Aufhebung*] of the earliest mode of production within the capitalist mode of production itself." (Engels, *Anti-Dühring*) In such a case, Engels adds, the state becomes the "real collective body of all capitalists. . . . The workers remain wage-workers, proletarians. The capitalist relationship is not done away with. It is rather brought to a head."* Even under a proletarian state the juridical act of the abolition of private property in the means of production does not mean the abolition of capitalist relations of production unless the workers come to *dominate*—indirectly—the conditions of production.** It is precisely the task of the proletarian dictatorship to ensure this domination through uninterrupted class struggles during the whole transition period.

Commodity production, of course, does not exist in socialism, understood in the sense of the "first phase of communism." As we mentioned earlier, the structure of productive forces/relations in a transitional society is such that though the *ownership* of the means of production—in the legal sense—is assumed centrally by the state (in the state sector) their *possession,* in the sense of *capacity* to put them to work, can be exercised only at the level of the enterprise, the unit of production. Hence the existence of commodity production in the transitional society. (Marx, *Critique of the Gotha*

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* Cf. Lenin: "Expropriation by itself, as a *juridical or political act,* is far from solving the problem . . . because the big landlords and capitalists must be replaced *in fact* by another administration—workers' administration—of the fields and factories." *Proletarian Revolution and the Renegade Kautsky* (1918). Emphasis added.

** See Charles Bettelheim, *Economic Calculation and Forms of Property* (Monthly Review Press, 1976).

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Program) Beginning with the "first phase of communism," with the immediate *social direction* of the conditions of production, this ownership/possession contradiction is resolved and, as Marx pointed out, "within the cooperative society based on common ownership of the means of production producers do not exchange their products." (*Op. cit.*) This is the basis of Engels's assertion—made in the course of his polemic against Dühring—that "the seizure of the means of production by *society*" puts an end to commodity production, and that consequently in such a society the necessary calculation of the quantities of labor time going into production is made *directly*.

IV

Page, while justly criticizing the economic program of the reform movement as having very little to do with socialism, does not, however, go to the root of the matter insofar as he *accepts* its basic tenet when he writes: "So long as the means of production are not privately owned and cannot be, the *necessary condition* of capitalism—*privately owned* capital—does not exist." Private property in the means of production is neither a necessary nor a sufficient condition for the existence of capitalism. Capitalism is simply the highest stage of commodity production where labor power itself is a commodity, and labor power remains a commodity in the absence of the direct and immediate domination of the conditions of production by the workers, irrespective of the particular *form* of property assumed by the means of production. That is why Page, while denying the socialist character of the economic program in question, cannot assert the truth that it is a *capitalist* program precisely because it aims to *perpetuate* the commodity character of labor power by denying the workers' domination over the conditions of production.

Closely related to this is a serious error that Page commits while discussing the concept of "class." His concept of class—which he wrongly identifies as Marxist—is based on the notion of ownership of the "factors of production" as defined in bourgeois political economy. As a justification he asserts, quite incorrectly, that "Marx utilized and built on the analytical tools developed within the classical English school of economics . . . [which held that] the significance of land, labor, and capital was that they are agents or factors of production. Since Marx *nowhere* contests this line of thought, it is reasonable to assume that the *same* was the case in his model." On the basis of this assertion Page adds that the "ownership of a factor of production is the fundamental criterion of class stratification." The whole statement

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unfortunately amounts to a *bourgeois* assessment of Marx's relation to classical political economy, a discussion of which is beyond the scope of the present paper. Suffice it to say that the general part of the statement reduces to a nullity the whole of Marx's *Capital* considered as a *critique of political economy.* As regards the specific question of the bourgeois "factor analysis," it is enough to read carefully the well-known chapter on the "Trinitarian Formula" in the third volume of *Capital* to see whether Marx "nowhere contests this line of thought."

As a matter of fact, for Marxists the ownership of the "factors of production" is not a fundamental criterion for defining classes. Otherwise the "bourgeoisie" and the "proletariat" as classes would have, for example, existed from all eternity. The starting point of the Marxist, as opposed to the bourgeois, analysis of classes is that they are linked with the phases of the *historical development of production.* In other words, it is the place that a particular group of human beings occupies in a "historically defined system of production" that determines its class character. (Lenin, *The Great Initiative*) It is in this perspective that capital ceases to be a "thing" or a "factor" and becomes a *relation* of production. Second, contrary to Page's assertion, what is essential for extracting the unpaid surplus product out of the direct producers is not so much ownership of means of production or of "factors of production" as control and domination *in fact* of the conditions of production by non-producers.

Let us return to the reform movement.

When we accept that centralization of the economy leads to great difficulties and that measures of decentralization are absolutely necessary, the question is what should be the nature and direction of decentralization. In the context of the kind of society we are discussing—that is, after the seizure of political power by the proletariat—we cannot be satisfied with any and every kind of decentralization. If the victory of socialism is the objective, the models of decentralization must be such that the plan becomes an instrument of increasing domination by the producers over the conditions of production. Now the basic element of decentralization in the reform movement's economic program is the increasing independence of the individual enterprises in relation to the center in decision-making. However, as Page justly notes, to Sik and his associates the enterprise implies management from which *labor is excluded.* Moreover, according to Sik, "the division of labor between economically directive activity and economically operational activity is necessary for the time being"; and because of their lack

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of knowledge and longer hours of work, "the producers themselves cannot take part in management work." This means, for all practical purposes, indefinite continuation of the capitalist division of labor, the wage-labor character of work, and the domination of the conditions of production by non-producers. In a word, the decentralization envisaged by these gentlemen is *capitalist* decentralization and not socialist decentralization which, on the contrary, would pave the way for increasing domination by the workers of the conditions of production and doing away with the ownership/possession duality, leading to the direct control by *society* of the process of production and thereby ending the commodity character of the products. While justly criticizing Sik on details, Page fails to see the capitalist character of his model, precisely because he accepts Sik's un-Marxist point of view on the relation between capitalism and private property in the means of production. The model is capitalist not because of the importance it gives to the market in relation to plan, nor because of the consumer sovereignty it promises, nor even because of the profit it prescribes as the principal stimulus to economic efficiency—in a word, not because of the particular types of *exchange* or *distribution* relations it assumes, but because of the type of *production relation* it postulates, i.e., the domination by non-producers over producers who continue to sell their labor power against wages. Exchange and distribution relations, it is well known, arise out of production relations.

V

The political model with which Mlynar and his associates wanted to replace what they considered to be the "dictatorship of the proletariat" is the model of parliamentary democracy. Interests other than those of the Communist Party were to be allowed institutionalized expression, but all within the framework of a National Front. Page correctly criticizes the model as non-Marxist, inasmuch as it postulates the submission of the workers to the administrators and managers of the new society. Wheeler, of course, accepts it as a model of "humane and democratic socialism."

What Page does not analyze and what seems to us to be crucial is the model's denial of class struggles as the moving force of history leading the transitional society toward communism. This denial is on two counts that are logically linked together: (a) acceptance of the development of production forces, or the so-called "scientific and technological revolution" (in the phrase favored by Richta and his associates), as the sole precondition of com-

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munism after the socialist revolution; and (b) rejection of the dictatorship of the proletariat in favor of bourgeois democracy.

The thesis that after the proletarian revolution and the abolition of private property in capital—juridically speaking—the development of productive forces will alone lead the society to communism is a manifestation of "economism" and an extension of the Second International's well-known thesis that the proletarian revolution could take place only in the most economically advanced capitalist countries (which was contradicted by the Leninist theory of the revolution breaking out in the weakest link of the imperialist chain, as well as by the fact of the October Revolution—"a revolution against *Capital,*" as Gramsci once put it, apparently paradoxically). Such a thesis on the transition to communism could be justified only on the assumption that classes and class struggles no longer exist in the transitional society; and that is precisely one of the reasons for the model's rejection of the necessity of the proletarian dictatorship in the transition period. But if one assumes that classes and class struggles no longer exist, is one not implying at least the *beginning* of the process of withering away of the state as a repressive machinery and consequently of *democracy* itself, as Engels and Lenin had emphasized? Why, then, restore the institutions of bourgeois democracy?

Secondly, what is proletarian dictatorship? This is, of course, the *bête noire* of the entire reform movement, and nowhere does it explicitly give a correct Marxist interpretation of the concept. Whenever the authors of the reform movement discuss the concept, more or less obliquely, they always discuss it in derogatory terms. It is true that their experience with what the post-1948 CP leadership *called* proletarian dictatorship might have given them some justification, since from all evidence proletarian dictatorship in the sense of the *broadest democracy* for the masses (coupled with the repression of the enemies of the masses) was scarcely, if at all, practiced in Czechoslovakia. But that should be no reason why these gentlemen, claiming to be Marxists, should, *à la bourgeoise,* make the notions of dictatorship and democracy mutually exclusive. For example, Wheeler, echoing them faithfully, speaks of socialism as moving "ahead from the stage of the 'dictatorship of the proletariat' to a more democratic model."

It is well known that democracy and dictatorship do not exist outside of class society, that there is no pure democracy or pure dictatorship in class society, and that they always co-exist. The regime that is democratic from the point of view of the class that dominates is at the same time dictatorial from the point of view

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of the class that is dominated. Proletarian dictatorship *is* democracy within the ranks of the proletariat (and its allies) and dictatorship over the bourgeoisie (and its allies). Exercising the most stringent repression over a handful of persons, it is at the same time the highest form of democracy involving the largest number of people, and as Lenin said, "associating the masses constantly, necessarily, and in the most decisive way with the democratic control of the state." Concrete examples are offered by the Paris Commune of 1871, the Soviets in Russia in the early years of the October Revolution, and the people's communes in China in our day. With the abolition of classes and consequently of the state as a repressive machinery, democracy also ceases to exist (along with dictatorship). All this is of course elementary Marxism, but requires reiteration in view of the unbelievable confusion which exists on this question. Witness Wheeler, who approvingly cites the resolution of the Thirteenth Congress of the Czechoslovak Communist Party to the effect that "the dictatorship of the proletariat has fulfilled its main historic mission in our society. . . . The development of our society is closely connected with an extension of socialist democracy, with the active participation of the working people in administration and management," and adds that "it was not possible to continue with the dictatorial methods of the past and at the same time have effective democratic administration . . . Democracy had been the goal of socialism from the very beginning." The entire formulation contradicts the meaning of proletarian dictatorship. If there was no socialist democracy in the sense of the workers' "active participation in administration and management," there was by definition no proletarian dictatorship either—not to speak of its fulfilling the "historic mission"—and, consequently, the "dictatorial methods" earlier practiced could not have been proletarian dictatorial methods. Secondly, the goal of socialism—that is, *scientific socialism*—has always been abolition of classes and of the state as a repressive machinery and hence of democracy as well.

In short, for the Czechoslovak Marxists there could be only two possibilities: (a) Classes and class struggles exist, necessitating the existence of the proletarian dictatorship. If in the past there was degeneration of this dictatorship, the point simply is to regenerate it in the proper sense of the term. Replacing it by "democracy" makes no sense; (b) Classes and class struggles no longer exist, necessitating the disappearance of the state as a repressive mechanism. Establishing "democracy"—not to speak of

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restoring parliamentary democracy—in such a context makes no sense either.

As a matter of fact, by opposing democracy and dictatorship as mutually exclusive and postulating parliamentary democracy as a "higher" form of political regime, what the reform movement offered to the Czechoslovak people was for all practical purposes, even *less* than bourgeois democracy because, as Page notes, any group not accepting the *Action Program* was to be denied legal existence, and Party members opposing the line were to be removed from any posts they might be holding.

VI

Let us conclude. Wheeler is an unconditional partisan of the reform movement and, as such, subject to our criticism of its essentially *bourgeois character*—but not, be it noted, subject to criticism from the point of view of the aggressors against Czechoslovakia—while Page offers valuable criticisms of the movement, which we think are of considerable importance. However, Page's critique is not *fundamental*. While questioning the reform program, he has no clear answer as to its *class* character. This is precisely because he accepts the program's confusion between the juridical and the real relations of production and, related to this, he offers a concept of class that is virtually independent of the relations of production. While he maintains that the model is not socialist, he holds at the same time that it is also not capitalist, since there is no provision in the model for private property in the means of production. All this is tantamount to an undialectical view of history, implying that a society after the seizure of political power by the proletariat and the abolition of private ownership in the means of production cannot *revert* to capitalism (except in the case of imperialist attack). This view, which embodies the denial of class struggles as well as the disarming of the proletariat during the transition period, is of course common to both groups of revisionists—the "reformists" as well as those who opposed them in the name of "limited sovereignty." Indeed, it is the great merit of Mao Tse-tung and the Chinese Communists under his leadership to have restored the revolutionary essence of Marxism-Leninism on this question by "going against the current."

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(*Continued from inside front cover*)
is to the press. The result, as all too many of you know, is that we are always behind, and this situation naturally gets worse at times like the present. All we can do is apologize and urge patience and forbearance.

Many thanks to those of you who returned copies of the December issue in response to the request in this space in the February issue. We could use more if there are any available "out there." And the same goes for last summer's special issue on China, a relatively large number of which have been ordered for classroom use, with the result that the stock of that issue (Vol. 27, No. 3) has been completely exhausted. We are not asking anyone who keeps a file of back issues to break up the collection, but please don't throw away either the summer or the December issues: send them back to us.

Noam Chomsky's piece in this issue is the foreword to a remarkable book, *The Arabs in Israel* by Sabri Jiryis, which will be published in June by Monthly Review Press. The author is an Israeli Arab scholar and lawyer who lived for many years in Haifa under Israeli rule and emigrated to Beirut, where he now lives, after more than a year's house detention. Based on personal observation and experience as well as exhaustive study of Israeli laws and administrative practice, *The Arabs in Israel* provides for the first time an authoritative analysis of one of the crucial aspects of the Middle Eastern situation as a whole. The Arabs in Israel, Jiryis shows, have been and remain "different" citizens, deprived of many of the rights and opportunities enjoyed by the Jewish majority. And he argues that despite partly successful government attempts to cope with some of the problems of the Arab minority, the experience of the Arab people in Israel, taken together with the armed resistance of Palestinians outside, has served to reinforce the Palestinian nationalism of the Israeli Arabs. A preliminary version of the book was published in Hebrew in 1966 and subsequently translated into Arabic, French, German, and Swedish. The author was asked by MR Press to update it for U.S. publication, and the result is an entirely new and greatly expanded book.

Word has been received from Africa and London of the arrest in Zambia in late January and February of at least 14 students and five lecturers at the University of Zambia following a peaceful demonstration in Lusaka in support of the Popular Movement for the Liberation of Angola (MPLA). Among the detainees are two long-time MR Associates, Lionel Cliffe and Robert Molteno, with whom we have corresponded from time to time about matters of mutual interest (like how to improve the distribution of MRP books in Africa). These actions on the part of the regime in Lusaka reflect the deteriorating economic situation in that country and the political bind Kaunda has got himself into by his support for the losing cause of the pro-Western neocolonialists Holden Roberto and Jonas Savimbi in Angola. A committee for Defense of University of Zambia Detainees (DUNZAD) has been established in London. It emphasizes, correctly in our judgment, that "international pressure and publicity are our most effective weapons to achieve the detainees' release." It urges letters and petitions to the following: President Kaunda, State House, Lusaka, Zambia; Vice Chancellor, Univ. of Zambia, P.O. Box 2379, Lusaka; and the Zambian Ambassador to your country and to the UN. Urgently needed funds and requests for further information should be addressed to DUNZAD, Basement 103 Gower St., London WC1E 6AW, England.

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